The Silver Word

PETROCHINA Company, Ltd. (PTR-NYSE-$49.39)
Buy

Investment Thesis:

We recommend the purchase of PetroChina (PTR) shares. PetroChina is the largest oil and gas producer and the second largest refiner and marketer in China. The company has maintained impressive natural gas reserve and production growth rates over the last few years and is in a position to be a major beneficiary of the expected growth of natural gas demand in China. FMR Corporation (Fidelity Management & Research Corp) and Warren Buffet's Berkshire Hathaway are major shareholders in the company.

Investment Pros:

PetroChina Company, Ltd. is one of the two major integrated companies in the country. China National Petroleum Corporation (CNPC), a state-owned entity is the company's majority shareholder, with a 90% stake. Public shareholders own the remaining 10% of the company's shares.

PetroChina considers natural gas to be critical for its long-term growth. It has significantly enhanced its natural gas reserve base over the last few years and is building the infrastructure to transport gas from its producing fields to key markets.

China's impressive economic growth has significantly increased its energy needs. The growth in oil, gas, and chemicals consumption is expected to continue for a long time, given the growth potential of the economy. This presents attractive opportunities for industry players that can meet the country's fast-growing energy needs. We believe that PetroChina will be one of the key beneficiaries of this positive trend.

The key element in the PetroChina story is natural gas. The Chinese government is promoting natural gas as a substitute to coal for power generation due to environmental concerns. The company's year-end 2003 natural gas reserves of 41 trillion cubic feet represented a 6% growth over the year-end 2002 levels and 14% above 2001 levels.

PTR is Leveraged to Benefit from Expected Growth in China

China's petroleum industry has undergone major changes over the last decade. In 1998, the Chinese government reorganized most state owned oil and gas assets into two vertically integrated firms: China National Petroleum Corporation (CNPC) and China Petrochemical Corporation (Sinopec). Before the restructuring, CNPC had been engaged mainly in oil and gas exploration and production, while Sinopec had been engaged in refining and distribution.

Our outlook for the Chinese oil and gas industry is positive. Rising oil demand and imports have made China a significant factor in world oil markets. The country's burgeoning energy needs are expected to provide significant growth opportunities to companies with exposure to China.

China was the world's second largest consumer of petroleum products in 2003, surpassing Japan for the first time, with total demand of 5.56 million barrels per day (bbl/d). China's oil demand is projected by Energy Information Administration (EIA) to reach 12.8 bbl/d by 2025, with net imports of 9.4 million bbl/d. As the source of around 40% of world oil demand growth over the past four years, Chinese oil demand already is a very significant factor in world oil markets.

Historically, natural gas has not been a major fuel in China, but given China's domestic reserves of natural gas, which stood at 53.3 trillion cubic feet (Tcf) at the beginning of 2004, and the environmental benefits of using natural gas, China has embarked on a major expansion of its gas infrastructure. Although natural gas currently accounts for only around 3% of total energy consumption in China, but consumption is expected to nearly double by 2010. This will involve increases in domestic production, and imports, by pipeline and in the form of liquefied natural gas.

Given growth projections for the Chinese economy, the country's energy needs will continue to grow. This provides attractive growth opportunities to companies engaged in every aspect of the Chinese oil and gas value chain, compared to most other markets in the world.

2003 Achieved Record High Net Profits, Full-year Dividend Announced

On March 24th of this year, PetroChina reported full-year 2003 net earnings of Chinese Yuan (RMB) 69.6 billion, up 48% from a year ago. Higher realized commodity prices were the key contributing factor to the significant year-over-year earnings growth. The company also announced a full-year dividend of RMB 0.18 per share ($2.15/ADR).

Oil and gas production during the year totaled 890 million oil-equivalent barrels, a 2.2% year-over-year increase. Crude oil production remained essentially flat from the 2002 level at 775 million barrels, while natural gas production increased by 14.3% to 691 billion cubic feet. PetroChina's average realized crude oil price of $27.20 per barrel was 21% higher than the 2002 level.

In the refining business, the company refined a total of 621.3 million barrels of crude oil, 9% more than the 2002 level. The capacity utilization rate of the company's refining assets averaged 85.6% during 2003, up from 79% in 2002. The year-over-year increase in PetroChina's gasoline and diesel production was 10% and 12%, respectively. The company's number of retail outlets increased by approximately 16% to 15, 230 stations, while retail sale volume increased by 19% to 22,300 tons.

Bullish Commodity Price Outlook

On Monday, July 19th, The Organization of Petroleum Exporting Countries decided to increase its production ceiling by half a million barrels a day in August. The benchmark U.S. crude gained 14 cents to $41.44 per barrel. The outlook for oil prices is positive, given doubts on production in major oil-producing countries as Iraq, Norway, Nigeria and Russia, as well as terror attacks on the U.S. ahead of the presidential election.

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